

# OPEN MEETING



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ORIGINAL

## MEMORANDUM

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Arizona Corporation Commission

DOCKETED

AUG 12 2008

TO: THE COMMISSION AUG 12 P 12:00

FROM: Utilities Division AZ CORP COMMISSION  
DOCKET CONTROL

DATE: August 12, 2008

DOCKETED BY	
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RE: STAFF REPORT FOR DIVERSIFIED WATER UTILITIES, INC.'S REQUEST FOR  
TERMINATION OF ITS OFF-SITE FACILITIES HOOK-UP FEE TARIFF  
(DOCKET NO. W-02859A-08-0137)

### Introduction

On March 6, 2008, Diversified Water Utilities, ("Company") filed notice with the Arizona Corporation Commission ("Commission") that its off-site facilities hook-up fee ("HUF") tariff would terminate at 11:59 p.m. on April 10, 2008. On March 20, 2008, Staff filed a memorandum asking for additional time to review and analyze data filed by the Company. Staff requested that the Commission suspend the tariff filing. The Commission granted Staff's extension request in Decision No. 70293, dated April 24, 2008.

### Customers

The Company is engaged in the business of providing water services to customers in northern Pinal County east and southeast of Queen Creek, Arizona. The Company provides services to approximately 1,200 metered customers.

### Compliance

A check with the Compliance Section of the Utilities Division indicates no compliance issues. The Company is current with the filing of its Annual Report and has filed an affidavit stating it is current in its property taxes.

### Consumer Services Analysis

Consumer Services reports the Company is currently in good standing with the Corporations Division.

A search of the Utilities Division database indicates that from January 1, 2005 through June 18, 2008, there were zero complaints, zero inquires, and zero opinions filed.

### **History of the hook-up fee ("HUF") tariff**

The Company's HUF tariff was authorized and approved by the Commission in Decision No. 61580, dated March 19, 1999, when the Company was serving less than 100 customers and was a relatively small water system utilizing a single well and storage tank. Subsequently, new growth occurred in the area as a result of both legal and illegal lot splitting. Smaller, "wildcat" lot-split developments were prevalent. By definition, a lot-split is the division of land into five parcels or less, while a subdivision is the division of land into six or more parcels. If the land is divided into six or more parcels, a public report and other documentation must be provided by the developer.

At the time, the Company agreed that HUFs were the appropriate mechanism available to make lot splitters provide their "fair share" of infrastructure costs because the Commission's main extension rule would be unsuccessful in securing advances to finance "backbone" water infrastructure.

The Company now states that formal subdivisions are the standard, and subdivisions within the Company's service area have now been organized in a legal manner. As such, the Commission's main extension rule (A.C.C. R14-2-406) would be effective.

### **Reasons for Termination**

The Company believes termination of the HUF tariff is appropriate for three reasons, summarized below:

1. Developers should pay for development – The Company wants to put the risk and financial responsibility for providing the initial costs of both the on-site and off-site "backbone" water infrastructure on the developer. Main extension agreements ("MXAs") would put the risks associated with building the water infrastructure on the developer.
2. The Company needs flexibility to allow qualified developers to perform actual construction – The Company states that "terminating the HUF and relying on the main extension rule will allow the Company to concentrate its manpower on current operations while delegating qualified users/developers the primary responsibility for the actual design and construction of the backbone plant." MXAs would save the Company manpower that can be utilized elsewhere.
3. The HUF tariff lacks flexibility – the Company states that the current HUF tariff does not address the fluctuating costs of steel and other components of a water infrastructure. MXAs would address these fluctuations.

**Company's Current Rate Base**

The Company's rate base is currently negative, based on the Company's April 30, 2008, financial data presented below:

Plant in Service	\$3,602,107
Accumulated Depreciation	<u>(503,469)</u>
Net Plant in Service	3,098,638
Advances in Aid of Construction	(1,175,512)
Refundable Meter Deposits	<u>(840,817)</u>
Contributions in Aid of Construction ("CIAC")	(1,286,444)
Accumulated Amortization of CIAC	<u>91,852</u>
Net CIAC	(1,194,592)
Total Rate Base	<u><u>\$(112,283)</u></u>

**Refunding of the MXAs**

As a result of having a negative rate base, the Company must begin to build equity at a much faster rate than those companies who use the minimum refund of 10 percent of gross revenues from water sales under A.A.C. R14-2-406(D). The Company proposes that the refund provision in future MXAs should be 20 percent until: (1) 25 years have passed or, (2) full repayment of the advance. Staff is agreeable to what the Company proposes.

Staff recommends approval of the Company's request to use MXAs as a means of building "backbone" water infrastructure, subject to the condition that the Company shall each year pay to the party making an advance under future MXAs, or that party's assignees or other successors in interest where the Company has received notice and evidence of such assignment or succession, a minimum amount equal to 20 percent of the total gross annual revenue from water sales to each bona fide consumer whose service line is connected to main lines covered by the MXA, for a period of not less than 25 years or until the advance is fully repaid, whichever is sooner.

Additionally, Staff recommends that the Company be put on notice that "backbone" plant shall be included in MXAs only when such plant is required to provide service exclusively to the applicant, i.e., "backbone" plant shall not be reserved.

**Future Development**

In response to a Staff data request on future development, the Company provided Staff with a preliminary service report prepared by Scout Engineering, LLC. This report estimates equivalent dwelling units to be approximately 5,167 units over the next five years. Along with the required infrastructure and yearly water requirements, the report estimates total infrastructure

costs to be \$6,763,650 of which \$4,391,950 will be generated by hook-up fees. The difference of \$2,371,700 would have to be fronted by the Company.

**Disposition of Current Hook-up Fee Fund**

As of April 30, 2008, the current balance of the Company's hook-up fee account is \$424,897. Staff recommends that the Company submit to Docket Control, within 90 days of the effective date of a decision entered in this matter, a plan acceptable to Staff demonstrating how monies from the existing hook-up fee account will be used to fund the construction of "backbone" plant before any advances from MXAs are required for "backbone" plant.

Staff also recommends that the Company not be allowed to subsequently apply for a new hook-up fee tariff until the Company has a capital structure consisting of a least 50 percent equity (not including advances and contributions).

**Staff Recommendations**

Staff recommends approval of the Company's request for termination of its Off-site Facilities Hook-up Fee tariff.

Staff recommends approval of the Company's request to use main extension agreements ("MXA"), as a means of building "backbone" water infrastructure subject to the following conditions:

1. The Company shall each year pay to the party making an advance under future MXAs, or that party's assignees or other successors in interest where the Company has received notice and evidence of such assignment or succession, a minimum amount equal to 20 percent of the total gross annual revenue from water sales to each bona fide consumer whose service line is connected to main lines covered by the MXA, for a period of not less than 25 years or until the advance is fully repaid, whichever is sooner.
2. The Company submit to Docket Control, within 90 days of the effective date of a decision entered in this matter, a plan acceptable to Staff demonstrating how monies from the existing hook-up fee account will be used to fund the construction of any "backbone" plant before any advances from MXAs are required for "backbone" plant.
3. The Company be put on notice that "backbone" plant shall be included in MXAs only when such plant is required to provide service exclusively to the applicant, i.e., "backbone" plant shall not be reserved.

THE COMMISSION

August 12, 2008

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4. The Company not be allowed to apply for a new hook-up fee tariff until the Company has a capital structure consisting of at least 50 percent equity (not including advances and contributions).

A handwritten signature in black ink, appearing to read "E.G. Johnson", with a long horizontal flourish extending to the right.

Ernest G. Johnson  
Director  
Utilities Division

EGJ:JMM:kdh/KOT

ORIGINATOR: Jeffrey M. Michlik

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

MIKE GLEASON  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
JEFF HATCH-MILLER  
Commissioner  
KRISTIN K. MAYES  
Commissioner  
GARY PIERCE  
Commissioner

IN THE MATTER OF DIVERSIFIED  
WATER UTILITIES, INC.'S REQUEST FOR  
TERMINATION OF ITS OFF-SITE  
FACILITIES HOOK-UP FEE TARIFF

DOCKET NO. W-02859A-08-0137  
DECISION NO. \_\_\_\_\_  
ORDER

Open Meeting  
August 26 and 27, 2008  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Diversified Water Utilities, Inc. ("Company") is engaged in the business of providing water services to customers in northern Pinal County east and southeast of Queen Creek, Arizona. The Company provides services to approximately 1,200 metered customers. Its current hook-up fee tariff became effective March 19, 1999, per Arizona Corporation Commission Decision No. 61580.
2. On March 6, 2008, the Company filed notice with the Arizona Corporation Commission ("Commission") that its off-site facilities hook-up fee ("HUF") tariff would terminate at 11:59 p.m. on April 10, 2008.
3. On March 20, 2008, Staff filed a memorandum asking for additional time to review and analyze data filed by the Company. Staff requested that the Commission suspend the tariff filing.

1           4.       The Commission granted Staff's extension request in Decision No. 70293, dated  
2 April 24, 2008.

3           5.       On July 8, 2008, the Company voluntarily agreed to extend the effective date of  
4 Staff's filing until August 12, 2008.

5           6.       On July 23, 2008, Staff and the Company met to discuss specific language to be  
6 included in the request for termination of the Company's off-site facilities hook-up fee tariff.

7           7.       A check with the Compliance Section and Consumer Services Section of the  
8 Commission finds that the Company is current on all of its filings.

9           8.       The Company's HUF tariff was authorized and approved by the Commission in  
10 Decision No. 61580, dated March 19, 1999, when the Company was serving less than 100  
11 customers and was a relatively small water system utilizing a single well and storage tank.  
12 Subsequently, new growth occurred in the area as a result of both legal and illegal lot splitting.  
13 Smaller, "wildcat" lot-split developments were prevalent. By definition, a lot-split is the division  
14 of land into five parcels or less, while a subdivision is the division of land into six or more parcels.  
15 If the land is divided into six or more parcels, a public report and other documentation must be  
16 provided by the developer. At the time, the Company agreed that HUFs were the appropriate  
17 mechanism available to make lot splitters provide their "fair share" of infrastructure costs because  
18 the Commission's main extension rule would be unsuccessful in securing advances to finance  
19 "backbone" water infrastructure. The Company now states that formal subdivisions are the  
20 standard, and subdivisions within the Company's service area have now been organized in a legal  
21 manner. As such, the Commission's main extension rule (A.C.C. R14-2-406) would be effective.

22           9.       The Company believes termination of the HUF tariff is appropriate for three  
23 reasons, summarized below:

24           Developers should pay for development – The Company wants to put the risk and  
25 financial responsibility for providing the initial costs of both the on-site and off-  
26 site "backbone" water infrastructure on the developer. Main Extension  
27 Agreements ("MXAs") would put the risks associated with building the water  
28 infrastructure on the developer.

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1     The Company needs flexibility to allow qualified developers to perform actual  
2     construction – The Company states that “terminating the HUF and relying on the  
3     main extension rule will allow the Company to concentrate its manpower on current  
4     operations while delegating qualified users/developers the primary responsibility  
5     for the actual design and construction of the backbone plant.” MXAs would save  
6     the Company manpower that can be utilized elsewhere.

7     The HUF tariff lacks flexibility – the Company states that due to increasing prices  
8     in steel, and other components that go into a water infrastructure system, the current  
9     HUF tariff does not address these fluctuating costs. MXAs would cover these price  
10    fluctuations.

11    10.    The Company’s rate base is currently negative, based on the Company’s April 30,  
12    2008, financial data presented below:

13       Plant in Service	\$3,602,107
14       Accumulated Depreciation	<u>(503,469)</u>
15       Net Plant in Service	3,098,638
16       Advances in Aid of Construction	(1,175,512)
17       Refundable Meter Deposits	(840,817)
18       Contributions in Aid of Construction (“CIAC”)	(1,286,444)
19       Accumulated Amortization of CIAC	<u>91,852</u>
20       Net CIAC	(1,194,592)
21       Total Rate Base	<u>\$(112,283)</u>

22    11.    As a result of having a negative rate base, the Company must begin to build equity  
23    at a much faster rate than those companies who use the minimum refund of 10 percent of gross  
24    revenues from water sales under A.A.C. R14-2-406(D). The Company proposed that the refund  
25    provision in future MXAs should be 20 percent until: (1) 25 years have passed or, (2) full  
26    repayment of the advance.

27    12.    Staff recommended that each year the Company shall pay to the party making an  
28    advance under future MXAs, or that party’s assignees or other successors in interest where the  
29    Company has received notice and evidence of such assignment or succession, a minimum amount  
30    equal to 20 percent of the total gross annual revenue from water sales to each bona fide consumer  
31    whose service line is connected to main lines covered by the MXA, for a period of not less than 25  
32    years or until the advance is fully repaid, whichever is sooner.

33    ...



14. In response to a Staff data request on future development, the Company provided Staff with a preliminary service report prepared by Scout Engineering, LLC. This report estimates equivalent dwelling units to be approximately 5,167 units over the next five years. Along with the required infrastructure and yearly water requirements, the report estimates total infrastructure costs to be \$6,763,650 of which \$4,391,950 will be generated by hook-up fees. The difference of \$2,371,700 would have to be fronted by the Company.

15. As of April 30, 2008, the current balance of the Company's hook-up fee account is \$424,897. Staff recommended the Company submit to Docket Control, within 90 days of the effective date of a decision entered in this matter, a plan acceptable to Staff demonstrating how monies from the existing hook-up fee account will be used to fund the construction of any "backbone" plant before any advances from MXAs are required for "backbone" plant

16. Staff also recommended that the Company not be allowed to apply for a new hook-up fee tariff until the Company has a capital structure consisting of a least 50 percent equity (not including advances and contributions).

1. The Company is an Arizona public service corporation within the meaning of Article XV, Section 2 of the Arizona Constitution.

2. The Commission has jurisdiction over the Company and the subject matter of the application.

3. Approval of the proposed tariff does not constitute a rate increase as contemplated by A.R.S. Section 40-250.

4. The Commission, having reviewed the Staff's Memorandum dated August 12, 2008, concludes that it is in the public interest to approve Staff's recommendations.

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ORDER

IT IS THEREFORE ORDERED that Diversified Water Utilities, Inc.'s request for termination of its off-site facilities hook-up fee tariff is granted.

IT IS FURTHER ORDERED that Diversified Water Utilities, Inc. shall each year pay to the party making an advance under future MXAs, or that party's assignees or other successors in interest where Diversified Water Utilities, Inc. has received notice and evidence of such assignment or succession, a minimum amount equal to 20 percent of the total gross annual revenue from water sales to each bona fide consumer whose service line is connected to main lines covered by the MXA, for a period of not less than 25 years or until the advance is fully repaid, whichever is sooner.

IT IS FURTHER ORDERED that Diversified Water Utilities, Inc. be put on notice that "backbone" plant shall be included in MXAs only when such plant is required to provide service exclusively to the applicant, i.e., "backbone" plant shall not be reserved.

IT IS FURTHER ORDERED that Diversified Water Utilities, Inc. submit to Docket Control, within 90 days of the effective date of a decision entered in this matter, a plan acceptable to Staff demonstrating how monies from the existing hook-up fee account will be used to fund the construction of any "backbone" plant before any advances from MXAs are required for "backbone" plant.

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IT IS FURTHER ORDERED that the Company not be allowed to apply for a new hook-up fee tariff until the Company has a capital structure consisting of a least 50 percent equity (not including advances and contributions).

IT IS FURTHER ORDERED that this Decision will become effective immediately.

**BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_\_ day of \_\_\_\_\_, 2008.

\_\_\_\_\_  
BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

DISSENT: \_\_\_\_\_

DISSENT: \_\_\_\_\_

EGJ:JMM:kdh/KOT

1 SERVICE LIST FOR: Diversified Water Utilities, Inc.  
2 DOCKET NO. W-02859A-08-0137

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4 2850 East Camelback Road, Suite 200  
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7 Curtis, Goodwin, Sullivan, Udall & Schwab, PLC  
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9 Phoenix, Arizona 85012-3205

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12 Arizona Corporation Commission  
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